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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
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SUBJECT: SOUTH AFRICA ECONOMIC NEWS WEEKLY NEWSLETTER FEBRUARY 9,
2007 ISSUE

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¶1. (U) Summary. This is Volume 7, issue 09 of U.S. Embassy Pretoria's South Africa Economic News weekly newsletter.

Topics of this week's newsletter are:

- Ambassador Opens BEE Conference
 - Pace of Growth Jumps to Fastest in Two Years
 - Weather Affects Expected Corn Harvest
 - South Africa's U.S. Exports Up 28%
 - Super Tax Proposed for Resources Sector
 - Eskom Expects to Make Nuclear Power Plant Decision in March
- End Summary.

Ambassador Opens BEE Conference

¶2. (U) Ambassador Eric Bost opened an American Chamber of Conference of South Africa workshop on Black Economic Empowerment on March 1. Over 200 companies and chambers attended the event. The Ambassador stressed the fact that American companies already understand the need for diversity and responsible corporate behavior, and noted that AmCham members employ 50,000 workers in South Africa and spend almost \$90 million per year on corporate social investment. The Ambassador stressed that American companies interested in long-term success in South Africa must embrace BEE: "BEE not only gives black South Africans opportunities," he said, "but also creates new opportunities and markets for American companies." He cautioned that BEE must remain flexible and sensitive to the practical needs of companies. The Ambassador closed his remarks by stressing that President Bush regards expanded bilateral business ties as a key part of American policy in South Africa.

¶3. (U) Department of Trade and Industry Deputy Director General Lionel October delivered the keynote address. October noted that the old debate about whether BEE would hamper economic growth has been overtaken by events: South Africa's economy, he stressed, has grown at unprecedented rates at exactly the moment when BEE was being formulated and implemented. "There is no contradiction between BEE and growth," he told the business audience. October also made the same point about BEE and FDI. October said that the underlying principle of the new BEE Codes is to broaden the base of BEE beneficiaries to include workers, small businesses and communities. "BEE is not just about putting equity in black hands," he said. He defended the decision to impose BEE rules on companies,

claiming it would have been impossible to leave black empowerment to the market. He stressed, however, that BEE must be realistic and financially sustainable.

Pace of Growth Jumps to Fastest in Two Years

¶4. (U) Economic growth accelerated to its fastest pace in more than two years in the fourth quarter of last year, far above market expectation. Gross Domestic Product (GDP) increased by 5.6% on a seasonally adjusted and annualized rate in the fourth quarter of 2006, up from the third quarter's revised growth of 4.5%. A Bloomberg survey of economists had forecast growth of 4.8% for the fourth quarter. Growth in the last three months of 2006 was the fastest since the third quarter of 2004, when it was at 7.2%. The main contributors to higher growth in the fourth quarter were the manufacturing sector, which contributed 1.4 percentage points to growth, and the finance, real estate and business services sector, which added one percentage point. These two sectors are the largest and second-largest sectors in the economy respectively, and together account for about 36% of GDP. The agricultural sector contracted by 8.4% as a result of low harvests in the fourth quarter. Continued contraction in the agricultural sector remains a drag on future growth.

¶5. (U) For 2006 as a whole, the economy grew at 5%, almost as high as 2005's rate of 5.1%. Growth is expected to slow down in 2007 as last year's interest rate hikes begin to affect consumer demand and the agricultural sector contraction, but increased investment by government, parastatals and the private sector should offset the slowdown to some extent. Overall, growth prospects for the economy remain favorable, and there are encouraging signs that the sources of growth are becoming more balanced. Analysts pointed out that the healthy rise in mining and manufacturing production in the final quarter of last year suggests that the weaker rand is doing good work in stimulating supply-side activity, while higher interest rates are having a modest dampening impact on consumer demand.

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Analysts noted that, assuming that planned infrastructure spending takes place and benefit the broader economy, SA is on track to reach the government's 6% GDP growth objective by 2010. (Business Day, February 28, 2007)

Weather Affects Expected Corn Harvest

¶6. (U) South Africa's commercial corn farmers planted about 2.6 million hectares of corn in 2006, which under normal conditions would be expected to yield at least 9.75 million tons when harvested by mid-2007. Although the rainfall season started late, November and December rainfall was good. Since January, rainfall has dropped dramatically while temperatures have increased. The prolonged hot and dry spell led to an official forecast on February 27 of 7.75 million tons, a drop of about 2 million tons from initial estimates, implying a loss to farmers of about R3.5 billion (\$500 million) at current high prices. The 7.75-million-ton estimate assumes normal weather for the rest of the season and could certainly decline if the drought continues and time for crop recovery runs out. The modestly good news is that a 7.75 million ton crop is still a 17% increase on the 6.6 million tons produced in the previous season when farmers cut back the area planted in an effort to balance supply and demand. South Africans normally consume about 8 million tons of corn for human and animal feed use, so the current crop estimate would roughly satisfy domestic food and feed demand. Imports of yellow corn from Argentina are common, especially for feed use. (Foreign Agricultural Service, February 27, 2007)

South Africa's U.S. Exports Up 28%

¶7. (U) U.S. Customs has just released 2006 trade data. South African exporters to the U.S. had a banner year, with total exports up 27.9% (in contrast to 10.9% total growth in U.S. imports). More important than the headline number, however, is the fact that processed/manufactured goods generally beat the trend: autos up

70.3%; iron and steel up 41.4%; and, furniture up 43.6%. To demonstrate the trend toward increasing value-added manufacturing in South Africa, exports of paper increased 594% while exports of wood pulp declined by 26.1%. In the sensitive area of textiles, South African exports declined 1.9%. U.S. exports to South Africa increased by 14.6%; at almost the same level as the U.S. worldwide export increase of 14.5%. U.S. sales of commodity products used in general infrastructure are growing the fastest: iron and steel, up 213%; cement, up 384%; and fertilizer, up 474.5%. U.S. exports of machinery, electrical machinery and aircraft were also up strongly at 14.2%, 18.8% and 27.0%, respectively. The only poorly performing categories of U.S. exports were autos, down 16%; wood, down 9%; and cereals, down 65%. The bilateral trade imbalance between the United States and South Africa increased by 54.8%, as South Africa's trade surplus increased to \$3.1 billion. South Africa's bilateral trade surplus with the U.S. equals about 1.1% of South Africa's GDP and it helps to balance out South Africa's large multilateral trade deficit.

Super Tax Proposed for Resources Sector

18. (U) South Africa's two synthetic fuel producers, privately-owned Sasol (coal-to-liquids) and state-owned PetroSA (gas-to-liquids), have been under government and public scrutiny ever since the rapid rise in crude oil prices began to be felt in the economy and peoples' pockets. Both Sasol and PetroSA were built with public funds, and, although Sasol was privatized in 1979, it enjoyed the protection of the SAG against low crude prices until the late 1990s. In July 2006, when crude prices were well above \$70 per barrel, both companies enjoyed the benefits of high international oil prices while using South Africa's relatively cheap coal, gas and electricity inputs. The companies made huge profits and few material benefits were passed on to consumers. At that point, the Minister of Finance proposed an investigation into windfall taxes on 'excessive' profits earned by the synfuels industry and appointed a Task Team to undertake such an investigation. The Task Team report produced on February 23 concluded that a windfall/super tax could be applied to both the synthetic fuel and the minerals industry. The report suggests that such a tax could kick in when crude prices exceeded about \$45 to \$55 per barrel and that, similarly, a price level could be set for each mineral commodity that would trigger a

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progressively larger tax take. The report also recommended credits/tax breaks for new investment and for prices below a set level (a floor price below which subsidies would apply). The Minister has said that the synfuel industry will be consulted before a decision is made. The key will be to apply a windfall tax/investment credit that will not discourage the industry from investing in badly needed additional synfuel capacity in South Africa.

Eskom Expects to Make Nuclear Power Plant Decision in March

19. (U) South African parastatal power utility Eskom is expected to announce plans for construction of a second nuclear power station following its March 2007 board meeting. The most likely location is adjacent to the country's sole commercial reactor in Koeberg near Cape Town. Eskom is believed to have already chosen a Pressurized Water Reactor (PWR) design which narrows the field of potential bidders. Westinghouse/Toshiba and French parastatal Areva are expected to be the main contenders. Consortiums from Russia and Korea have also expressed interest in the project. The selection process is expected to take another year with an award to be made in March 2008. Following the board meeting, Eskom may also announce plans for construction of smaller Pebble Bed Modular Reactors as well as plans for additional coal-generation plants. The country has been suffering from rolling blackouts and additional generation capacity is desperately needed. (Engineering News, February 16, 2007)

BOST